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August 10, 2000

In Re: Change in Ownership - Rebutting Deed Presumption upon Real Property Transfer to LLC.

Dear Mr. _____ :

This is in response to your letter of May 2, 2000, in which you requested our opinion concerning the rebuttal of the deed presumption upon the disproportionate transfer of real property from individuals to an LLC. For the reasons hereinafter explained, it appears from the evidence submitted that only legal title to the property transferred by the deed dated August 13, 1999, and beneficial ownership transferred on April 18, 2000 when the condition precedent (i.e., start of construction) was met. The ultimate conclusion however, is a question of fact for the assessor's determination based on all relevant documents in existence at the time the deed was recorded.

You have described the following facts for purposes of our analysis:

1. On July 28, 1999, _____ LLC ("LLC") was formed and its articles recorded with the Secretary of State, with the _____ LLC Amended Operating Agreement ("Agreement") listing the following ownership interests in the capital and profits:

MJ and LJ, spouses, as trustees of their revocable trust owing 20.175%,
RJW and RMW, spouses, as trustees of their revocable trust, owning 20.175%,
JTD, an individual, owning 8.65%
SLP, an individual, owning 1.00%
S _____, ("Ray and Wendy"), spouses, owning 50%
2. On August 13, 1999, Ray and Wendy recorded a grant deed transferring a parcel of land they owned as community property to the LLC as part of a plan to develop the property. The _____ County Assessor's office treated the transfer as a change in ownership and mailed a notice of supplemental assessment to the LLC, reflecting reappraisal of the property.

3. Taxpayers contend that the August 13 deed transferred mere legal title to the LLC, which functioned as nominee for Ray and Wendy, and that beneficial ownership remained in Ray and Wendy until April 18, 2000, when construction on the property began. As evidence of this, they cite provisions in the LLC Amended Operating Agreement, which state that,

“Notwithstanding any other provision to the contrary, until construction begins, Ray and Wendy shall retain all ownership rights and burdens and may withdraw such property or capital account upon demand, subject to the conditions set forth herein at Section 3.5. In addition, until construction begins (1) the Company shall hold record title as nominee for Ray and Wendy and (2) Ray and Wendy shall retain, through the Company, their present interest in the real property ... including the beneficial use thereof.” (Paragraph B, page 1, LLC Agreement)

4. Since construction began on April 18, 2000, taxpayers assert that the transfer of beneficial ownership of the property to the LLC occurred on that date, and that prior to that date the LLC held title only as a nominee.

Your question is whether the present beneficial ownership of the parcel transferred to the LLC under Revenue and Taxation Code Section 60 on the date shown on the deed (August 13, 1999) or on the date construction began (April 18, 2000). Having discussed this question with the assessor's office, both parties agree to consider the conclusion reached by the Board of Equalization Legal Division as a recommendation for resolving this dispute. As explained below, although our opinion is that the LLC Agreement and other documents submitted support the conclusion that the date of the start of construction is the date beneficial ownership transferred -- the assessor's determination is final, since this is primarily a question of fact.

LAW AND ANALYSIS

Change in Ownership Deed Presumption and Holding Agreements

Section 60 defines a change in ownership as "a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." Under section 61(j), a change in ownership includes:

The transfer of **any interest in real property** between a corporation, **partnership**, or other legal entity and a shareholder, **partner**, or **any other person**.

This provision applies to all legal entities, including LLCs, and requires the assessor's determination of change in ownership when real property is transferred from individuals to an LLC, unless an exclusion or exception applies. The exception you are asserting is found in Property Tax Rule 462.200(b). The purpose of Rule 462.200(b) is among other things, to enable assessors to easily identify the "*owner(s)*" of a property and the "*date*" that the property changed ownership. Rule 462.200(b) states that when more than one person's name appears on a deed, there is a rebuttable presumption that all persons listed on the deed have ownership interests in that property.

(b) Deed Presumption.

* * *

In overcoming this presumption, consideration may be give to, but not limited to, the following factors:

- (1) The existence of a written document executed prior to or at the time of the conveyance in which all parties agree that one or more of the parties do not have equitable ownership interests.
- (2) The monetary contribution of each party. The best evidence of the existence of any factor shall be an adjudication of the existence of the factor reflected in a final judicial finding, order, or judgment. Proof may also be made by declarations under penalty of perjury (or affidavits) accompanied by such written evidence as may reasonably be available, such as written agreements, canceled checks, insurance policies, and tax returns.

These provisions are consistent with Evidence Code section 662 which states that the owner of the legal title to property is presumed to be the owner of the full beneficial title and that the presumption may be rebutted only by clear and convincing proof. Proof that is "*clear and convincing*" constitutes evidence that is explicit and unequivocal that beneficial title transferred to a person or entity other than those named in the deed, *or that title is transferred at a point in time distinct from the date of delivery of the deed.* (1 Witkin, California Evidence, 3rd Ed. 1986, Sec. 160.)

It has also been our position that where the parties have executed a written LLC or partnership agreement, the designation of their own relationships and their rights to exercise full ownership interests over the property as partners/members should be given the greatest weight. In fact, where a written agreement exists, the parties may not avoid liability or any of the other incidents of partnership/membership with regard to the property held in the partnership or LLC.¹

¹ We have opined in the past, for example, that where there is a written partnership agreement, that agreement is controlling for all purposes in determining the property tax consequences, on and after its effective date (even where the "Statement of Partnership" has been filed with the county recorder per Corporations Code section 15010.5). (See Annotation No. 220.0504, attached.) Thus, the partners cannot escape the consequences of their agreement as the controlling document in establishing the names of the partners, the nature of their interests, the assets owned by the partnership, the business purpose, and other terms of the partnership entity they created.

(Witkin, Summary of California Law, 9th Edition, p 423) The evidence you submit, i.e., primarily the LLC Agreement, but also federal tax returns and insurance statements, seems to rebut the presumption that the beneficial ownership of the property transferred to the LLC on the date the deed was recorded.

Rule 462.200(c) implements the above definition of change in ownership in Section 60 by describing the exception for transfers under holding agreements. The rule makes it clear that a transfer of property from the owner to an entity holding title pursuant to a holding agreement, or from the entity holding title back to the owner is **not** a change in ownership – where the terms of the holding agreement establish a principal-agency or a nominee relationship between the owner and the entity. Subdivision (c) states:

Holding agreements. A holding agreement is an agreement between an owner of the property, hereinafter called a principal, and another entity, usually a title company, that the principal will convey property to the other entity merely for the purposes of holding title. The entity receiving title can have no discretionary duties but must act only on explicit instructions of the principal. The transfer of property to the holder of title pursuant to a holding agreement is not a change in ownership. There shall be no change in ownership when the entity holding title pursuant to a holding agreement conveys the property back to the principal.

- (1) There shall be a change in ownership for property subject to a holding agreement when there is a change of principals.
- (2) There shall be a change in ownership of property subject to a holding agreement if the property is conveyed by the holder of title to a person or entity other than the principal.

This rule was applied to a situation similar to the instant case in Parkmerced Co. v. City and County of San Francisco (1983) 149 Cal.App.3d 1091, involving a nominee under a partnership agreement. The plaintiff was a partnership, Parkmerced Company, whose general partners were two corporations. The partnership was formed for the purpose of acquiring and operating specified real property, Parkmerced. The partnership agreement provided that title to the property would be held by one of the partners, Parkmerced Company, as nominee² for the partnership. As described in the agreement, the partnership, through its nominee Parkmerced Company, purchased the Parkmerced improvements and leased land, and Parkmerced Company took title to such property on behalf of the partnership. The nominee was subsequently merged

² A nominee, according to Black's Law Dictionary, Fifth Edition, page 947, is an "arrangement for holding title to real property under which one or more persons or corporations, pursuant to a written declaration or trust, declare that they will hold any property that they acquire as trustees for the benefit of one or more undisclosed beneficiaries.

into another corporation, both of which were wholly owned by the same person. The latter corporation, as successor nominee to the real property, later conveyed the property back to the partnership. The court held that no change in ownership occurred "upon the transfer of bare legal title without a corresponding transfer of the beneficial use thereof," and that since the nominee corporation and its successor held no more than "bare legal title" to the property, the transfer from the nominee's successor to the partnership was not a change in ownership.

The court stated at page 1095:

"...Today it is not all uncommon for individuals, or corporations such as title companies, to hold 'bare legal title' to property for the owner of its beneficial interest. Such a transaction is of the nature of a resulting trust 'which arises from a transfer of property under circumstances showing that the transferee was not intended to take the beneficial interest,' and the transferee has no duty other than to deliver the property to the person entitled thereto, upon demand. ... And such a transfer, when made, will be of the property's 'bare legal title' to the person already entitled to its 'beneficial use'."

Transfer to LLC under Terms of LLC Agreement

The issue here is whether Ray and Wendy, through the specific provisions in the LLC Agreement, transferred the beneficial ownership of the property upon recordation of the August 13, 1999 deed, or upon the April 18, 2000 start of construction on the property. The terms of the LLC Agreement, the other evidence, and the parties' actions pursuant to the Agreement indicate that beneficial ownership transferred on April 18, 2000.

From the standpoint of rebutting the deed presumption, the LLC Agreement appears to be reliable evidence in conformity with the requirements of Rule 462.00(b). It is a written agreement executed on July 28, 1999, prior to the time of the August 13 deed conveyance. There are several sections in the Agreement, in which the parties expressly provide that the LLC does not have equitable ownership interests until certain conditions precedent are met. First, as noted above in the recitals in paragraph B, page 1, the parties state that, "until construction begins, Ray and Wendy shall retain all ownership rights and burdens and may withdraw such property or capital account upon demand, subject to the conditions set forth herein at section 3.5." Section 3.5 of the Agreement deals with the withdrawal of a member's capital contribution to the LLC and provides as follows:

"A Member shall not be entitled to withdraw any part of the Member's Capital Contribution or to receive any distributions, whether of money or property from the Company, except as provided in this Agreement.

Only in the event that construction has not begun on the property within two years from the date of this Agreement, Ray [also representing his spouse] shall

have the right to withdraw from Company. Ray shall deliver a written Notice of withdrawal to all other Members. Within 90 days from receipt of said Notice of withdrawal being delivered to all other Members, in exchange for his Membership interest, Ray shall receive from the Company the balance of his capital Account in cash or cash equivalent, or at the option of the remaining Members, reconveyance of the Real Property that Ray originally contributed as set forth in Exhibit B. If the remaining Members elect to reconvey the Real Property instead of paying cash, said Real Property shall be reconveyed in its then current condition. This limited right of withdrawal shall not be affected by Article VIII herein.” (Emphasis added)

Thus, although the Agreement was executed and the percentage interests of each of the LLC Members established on July 28, 1999, if construction did not commence within two years, (on or before July 28, 2001), Ray and Wendy had the right to withdraw their capital account or the property and themselves from the LLC without further obligation. Per the Agreement, the Members expressed an intent to hold legal title and to obtain government approvals and secure financing for the development on the property, subject to Ray and Wendy’s “right of withdrawal.” Article XIII contains language in section 8.1, (page 12 of the Agreement) which states that no member has the right to withdraw during the first two years.³ Read together with section 3.5 above, Ray and Wendy are the express exception.

Secondly, the Agreement states unequivocally that the LLC is merely the nominee holding legal title to the property until construction begins. As quoted above from page 1 of the Agreement, “until construction begins, (1) *the Company shall hold record title as nominee* for Ray and Wendy, and (2) Ray and Wendy *shall retain, through the Company their present interest in the real property ... including the beneficial use thereof.*” In the Parkmerced case, the court looked at the deeds, the partnership agreement, and other documents to find language indicating that title was taken by the partner as a nominee. The court determined that words and phrases like, “as nominee for,” “on behalf of,” and “holding record title for,” manifested this intent. This is obviously the situation here, in that the Agreement clearly provides that the LLC shall hold only “record title as nominee for” Ray and Wendy. Based on such language, the August 13 deed conveyance was, in effect, a transfer of the real property to a nominee LLC with the LLC merely holding bare legal title to the property as nominee. As such, there would be no change in ownership for property tax purposes.

³ Section 8.1 states in pertinent part:

“After the initial two years of operations beginning on the date of this Agreement, a Member may withdraw from the Company at any time by giving Notice of Withdrawal to all other Members at least 60 calendar days before the effective date of withdrawal. Prior to the expiration of the initial two years, no Member may withdraw without prior written consent of all remaining Members.”

From the standpoint of treating the August 13 deed conveyance to the LLC as a transfer made pursuant to a holding agreement, several provisions in the Agreement would support this conclusion. First, express language in the agreement states that the LLC is only *holding record title* until construction begins. Secondly, the page 1 of the Agreement states that Ray and Wendy *shall retain ... their present interest in the real property ... including the beneficial use thereof.*” Thirdly, based on the Agreement terms, the LLC tax returns reported only the expenses related to the development, while Ray and Wendy continued to report all income and expenses related to 100% of the real property. Ray and Wendy continued to protect their beneficial interest in the property through their homeowner’s insurance policy, and the LLC’s insurance coverage for the property began on April 18, 2000.

Finally, the date upon which beneficial title to the property would transfer is clearly described in the Agreement as the date “*construction begins.*” Rule 462.260(a)(1) provides that in sales transactions, “Where the transfer is evidenced by recordation of a deed or other document, the date of recordation shall be rebuttably presumed to be the date of ownership change. This presumption may be rebutted by evidence proving a different date to be the date all parties’ instructions have been met in escrow or the date the agreement of the parties became specifically enforceable.” The phrase “*until construction begins*” is used numerous times throughout the Agreement to identify the date that the parties’ instructions for the transfer of beneficial ownership of the property from Ray and Wendy to the LLC would be met. The only other date mentioned is “*two years from the date of this Agreement*” (July 28, 2001) which, under Section 3.5 is the deadline by which construction must begin, or Ray and Wendy may demand reconveyance of legal title to the property. The facts indicate that the parties fully executed these terms in that construction began before the deadline, and Ray and Wendy transferred beneficial ownership of the property to the LLC on the date of the start of construction, April 18, 2000.

While the nature and percentages of each Member’s interests in the LLC was not important as long as the LLC merely held legal title and functioned as the “nominee” for Ray and Wendy, once construction began and the beneficial interest in the property transferred, a change in ownership occurred. Since Ray and Wendy owned only 50% of the LLC interests, the exclusion under section 62(a)(2) would not apply, and all of the property was subject to reappraisal on that date.

Notwithstanding the foregoing analysis, the taxpayer claiming the benefit of an exception or exclusion has the burden of establishing to the satisfaction of the assessor that he or she qualifies for the benefit based on the specific facts of the transaction. In cases where formal recorded documents, such as deeds and agreements, might fail to contain all of the information which the assessor believes is necessary to establish the taxpayer's claim, then the assessor is entitled to require that the taxpayer's representations be further supported by clear and convincing evidence. (Evidence Code Section 662.) Moreover, where the issue bears in part on whether the normal incidents of a legal entity relationship – such as an LLC -were observed, the assessor may

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demand a variety of documents to establish these facts. If there are unanswered factual questions here, it seems clear that the assessor is entitled to require the submission of items, such as, the change in ownership statement (BOE 1-B), any documents manifesting the LLC's acquisition of beneficial ownership on April 18, 2000, or other relevant evidence supporting the taxpayer's claim that the transfer to the LLC occurred on the start of construction and not on the date of the deed was recorded.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on the present law and facts set forth herein. Therefore, they are not binding on any person or entity.

Sincerely,

/s/ Kristine Cazadd

Kristine Cazadd
Senior Tax Counsel

KEC:tr
prop/prec/llc/00/05kec

Attachments (Annotations 220.0504, C 9/3/98; 220.0504, C 3/23/87)

cc: Honorable David W. Wynne
Tuolumne County Assessor

Mr. Richard Johnson, MIC:64
Mr. David Gau, MIC:64
Ms. Jennifer Willis, MIC:70